

as a result of rate rebalancing pursuant to subsection (c) of K.S.A.1996 Supp. 66-2005 and subsection (a) of K.S.A.1996 Supp. 66-2007. Such revenues shall be recovered on a revenue neutral basis. The revenue neutral calculation shall be based on the volumes and revenues for the 12 months prior to September 30, 1996, adjusted for any rate changes."

K.S.A.1996 Supp. 66-2015 provides:

"The commission shall not enforce any provision of this act nor any order entered by authority of this act which is specifically preempted by the federal act."

As noted previously, "revenue neutral" refers to the replacement of revenues lost to LECs by the ordered reductions in intrastate rates by payments from the KUSF, by an increase in pay telephone rates, and by the elimination of free directory assistance calls.

In relevant part, the Court of Appeals stated:

"The revenue neutral concept is foreign to the Federal Act and was obviously intended by the Kansas Legislature to protect revenues by incumbent LECs facing a \$111.6 million loss of earnings as a result of reductions in long distance rates and toll charges.... This legislation is inconsistent with the provisions of the Federal Act, specifically §§ 254(b)(4), (b)(5), (f), and (i), and prevented the KCC from performing its regulatory responsibilities in general and insuring compliance by carriers with § 254(k) of the Federal Act.

....

"... The funding level of \$111.6 million for the KUSF was preordained by the Kansas Legislature once the concept of revenue neutrality and the prohibition against investigation of profits was written into the Kansas Act.... This made inevitable the KCC decision to set the funding level of the KUSF in an amount equal to the intrastate access and toll reductions.

"The result is a final order that fully protects incumbent LECs by shifting lost revenues from one corporate pocket to another while requiring all other providers and consumers to bear the financial burden of "revenue neutral" regulation.... Finally, the KCC order has created a \$111.6 million fund that bears no rational relation to the concept of universal service and its cost.

....

"... [T]he concept of revenue neutrality [is]

clearly inconsistent with the obligation of the KCC to ensure just and reasonable rates and charges for the consumers of Kansas.

....

"CMT and KCFN maintain that KUSF contributions under the KCC orders are not made on an equitable and nondiscriminatory basis. In part, their argument is that the revenue neutral requirement of the Kansas Act gives the LECs an unfair competitive advantage.... We have no doubt that the KCC, upon remand, will give these issues careful consideration.

"CMT has also asserted that the KCC orders have a discriminatory impact against wireless companies ... and that it is anti-competitive to force them to subsidize the incumbent LECs....

....

"Upon remand, the KC must disregard the concept of revenue neutrality ... as it is wholly inconsistent with the Federal Act and the public policy of Kansas as expressed in K.S.A.1996 Supp. 66-2001." 24 Kan.App.2d at 237-41, 943 P.2d 494.

In its petition for review, the KCC argued that the Federal Act does not preclude revenue neutrality for local exchange companies when making implicit support explicit; the revenue neutral phase-down of access charges represents a transition to a cost-based universal service fund; if the KUSF had been called something else, such as the Transition Fund, no section of the Federal Act would have been applicable to the revenue neutral phase-down; the KCC, with regard to the KUSF, is more or less following the path of the FCC, with regard to the Federal Universal Service Fund (FUSF); an abrupt transition to cost-based rates could be highly disruptive to the industry and have an *699 unfavorable impact on customers; the Kansas Act's provision for initial revenue neutral recovery, when access charges are reduced, and the KCC orders to that effect, minimize the likelihood of such a disruption; the Kansas Legislature, not the Court of Appeals, has the authority to determine how best to implement the federal mandate to make implicit subsidies explicit; and the legislature has determined that revenue neutrality is required in the first instance during a transition phase.

In their joint petition for review, SIA and Independent Telecommunications Group complain, among other things, that the Court of Appeals

incorrectly commingled the concept of revenue neutrality with the no audit or earnings review provision.

In its petition for review, SWBT argued that, at the federal level, the FCC has taken actions implementing price cap regulation and universal service that mirror the requirements of the Kansas Act and, over a decade ago, the FCC restructured interstate access charges in a revenue neutral manner. SWBT concludes from this that the revenue neutral provisions of the Kansas Act are clearly consistent with federal policies.

Sprint addressed the issue in its petition for review by arguing that revenue neutrality is transitional and that because "the KCC's decision to establish an initial transitional KUSF, based on current funding requirements subject to future modification, is similar to the FCC's Universal Service Report and Order, it is obvious that the KCC's Order is consistent with the Federal Act." Sprint further argues, among other things, that "nowhere in the Federal Act does it state that revenue-neutral plans are prohibited."

In its response to the KCC petition for review, Multimedia Hyperion, KCFN, and CMT Partners argued that (1) revenue neutrality was not transitional but a permanent feature of the KUSF; (2) even if it were transitional, the Federal Act contains no exemption for transitional programs; (3) the FCC's means of implementing a federal universal service fund is irrelevant; and (4) revenue neutrality is a means to protect LEC revenue, not a means to ensure affordable telecommunications services for Kansas residents.

The KCC takes the position that (1) the FCC, not the courts, has jurisdiction over the matter of barriers to entry; (2) revenue neutrality is a necessary first step in removing implicit support payments; and (3) "[T]he KCC is statutorily required to 'periodically review the KUSF to determine if the costs of qualified telecommunications public utilities ... to provide local service justify modification of the KUSF.' K.S.A. [1996 Supp.] 66-2008(d). Thus, although the KCC was required to assure the local exchange companies revenue neutrality when they reduced their access charges, in the long term the KCC is required to review the cost of providing local service

and modify the KUSF accordingly."

SWBT argues that revenue neutrality as well as the KUSF is subject to eventual change.

[1] The parties have filed a multitude of other supplemental briefs. We have examined the record and studied the briefs. The legislature determines utility policy, and so long as a legislative act does not contravene federal or state law, courts should not interfere with it, even though the action taken appears, to the court, to be unsound and not the best way, or even a good way, to carry out the stated purpose of the act.

Prior to the revenue neutrality concept, the KCC had procedures in place to give the telecommunications industry an opportunity to make a profit. A large part of the revenue came from access charges and long distance rates. The legislature heeded the concern that lost revenue from reduced access charges needed to somehow be replaced by the Act.

[2] Supposedly, the consumers were paying a fair total price for services prior to the Kansas Act. The legislature based the Act, which replaced the lost revenues, on that premise. That premise, when placed under close scrutiny, does not, and cannot, always show that each part of the cost-shifting act is a fair change. However, a constant arranging and rearranging of additional costs goes *700 on between the regulatory agency and the public utility--always with the purpose of arriving at a fair total price. Here, the legislature sets up a procedure to insure that the utilities would have the same revenue under the new Act as they had prior to the Act. We hold the revenue neutral concept is not prohibited by or contrary to the Federal Act. When Kansas passed the Act in question, there were no federal regulations in place. We do not have before us the federal regulations concerning the Federal Act.

B. AUDIT AND EARNINGS REVIEW

K.S.A.1996 Supp. 66-2005(u) provides:

"(u) No audit, earnings review or rate case shall be performed with reference to the initial prices filed as required herein."

"As required herein" apparently refers only to

prices filed pursuant to K.S.A.1996 Supp. 66-2005(b) by companies that have elected price cap regulation. Apparently, no company had made such an election when this appeal was filed.

In relevant part, the Court of Appeals stated:

"[I]n any event, there was to be no audit, earnings review, or rate case with reference to an LEC's initial prices filed pursuant to K.S.A.1996 Supp. 66- 2005(b)....

"... It is impossible for the KCC to determine an affordable rate for universal service without being able to perform an audit or earnings review of the incumbent LECs....

"What is the cost of basic telephone service in Kansas? We have no answer from the record before us. What is the cost to provide universal service? We have no answer from the record before us. The funding level of \$111.6 million for the KUSF was preordained by the Kansas Legislature once the concept of revenue neutrality and the prohibition against investigation of profits was written into the Kansas Act....

"... Finally, the KCC order has created a \$111.6 million fund that bears no rational relation to the concept of universal service and its cost.

....

"... Likewise, the KCC must disregard the provision of K.S.A.1996 Supp. 66- 2005(u) that prohibits any audit or earning[s] review. The KCC cannot meet its general regulatory responsibilities or those mandated under the Federal Act without a complete and thorough review of the earnings of the LECs." 24 Kan.App.2d at 237-41, 943 P.2d 494.

There is no indication that the Court of Appeals was basing its decision on a belief or understanding that the no audit or earnings provision applied only to prices filed by companies that had elected price cap regulation and that no company had made such an election at the time this appeal was filed.

In its order on reconsideration, the KCC stated that it would need to reevaluate the KUSF for consistency with the FCC universal service order guidelines once the FCC order was issued. In its brief filed on June 3, 1997, and in its May 28, 1997, motion for clarification, the KCC acknowledges that the May 8, 1997, FCC order requires that universal service orders be based on cost studies. The FCC order finds that the states are responsible for

identifying existing implicit universal service subsidies and emphasizes that the revenues of the carriers must be carefully examined. The KCC has said that it will comply with the FCC order by performing and implementing cost studies in connection with the KUSF.

The KCC was caught in a "catch 22" situation. This case started and the record was made without federal regulations defining the Federal Act. Federal regulations have since been adopted. The Court of Appeals appears to have obtained copies, although they were not available and thus not considered by the KCC when it issued its order. While this appeal was pending, the KCC would be reluctant to, if not prevented from, adopting different rules, regulations, and rates.

[3] As we read the Kansas Act, it does not prevent the KCC from making appropriate adjustments and performing a cost study or from conducting an audit or earnings review at this time. As we view what the legislature did, it assumed the rates that existed when the Act in question was *701 adopted, were not unreasonable, arbitrary, and capricious, i.e., in compliance with Kansas law. The legislature started with this premise. The legislature had to start with a figure in mind, and the fact that it chose a different method of obtaining a starting figure than what the court might have done, does not require us to hold that it violates K.S.A. 77-621. We hold that the legislature has the authority to start from this premise and the Act, insofar as this issue is concerned, is valid.

C. KCC REGULATORY RESPONSIBILITIES

The Court of Appeals held that the concept of revenue neutrality and the prohibition against audits and earnings review prevent the KCC from performing its regulatory responsibilities in general, K.S.A. 66-1,187 et seq., and are inconsistent with the obligation of the KCC to ensure just and reasonable rates and charges for the consumers of Kansas. The Court of Appeals further held the revenue neutrality and no audit provisions were wholly inconsistent with the public policy of Kansas as expressed in K.S.A.1996 Supp. 66-2001.

Apparently, the holding was based on its determination that (1) the revenue neutral provision kept the KCC from determining the appropriate

In the Matter of a General
Investigation into Competition
Within the Telecommunication
Industry in the State of Kansas

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Docket No. 190492-U
94-GIMT-478-GIT

Testimony

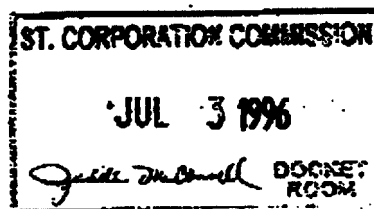
Prepared By

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Kansas Corporation Commission

July 3, 1996



KCC STAFF - LAMMERS

1 rate case. Staff is open to discussions with companies that might be interested
2 in alternative regulation.

3 Q. SWBT has indicated its desire for alternative regulation. How will this work
4 for them in relationship to the KUSF?

5 A. From the way I have analyzed the numbers it does appear that SWBT could
6 rate rebalance and not have to draw on the KUSF for support. If the actual
7 numbers for the 12 months ending 9/30/96 indicate the rebalancing can be
8 covered by an amount close to \$ 4.55, then I think that is what should be
9 done. To summarize for the Commission, Staff has taken three exceptions to
10 SWBT's estimation of the rebalancing amount and method:

11 • The rebalancing amount is determined by the 12 months ending
12 9/30/96 not a growing amount each year of the three year phase in.

13 • The amount should be determined by the revenues and quantities
14 adjusted for rate changes. Also significant billing errors or corrections
15 should be excluded.

16 • The rebalancing needs to apply to all residence and business lines and
17 not exclude multi-line, trunks and Plexar.

18 Staff's position on these issues will need to prevail for SWBT to reach
19 revenue neutrality and not draw from the KUSF.

20 Q. What does it mean if SWBT is not drawing from the KUSF?

21 A. It means that the KUSF is not paying any support for rural exchanges to
22 SWBT nor to any ALEC serving residence customers in those exchanges.
23 SWBT would still be required to provide quality service to those service areas
24 and follow through on its commitments in TeleKansas II for the
25 provisioning of service to schools, etc.

26 Q. Aren't you concerned that SWBT will lose customers in the metro areas and
27 be hampered in continuing to provide service in the rural areas?

28 A. Staff had been extremely concerned about this issue. Staff did not want the

KCC STAFF - LAMMERS

Commission to be faced with a threat to universal service in SWBT's service areas because SWBT was losing market share. When I realized that the state's responsibility was limited to \$ 36.88 per line, I was no longer concerned. Even for the number of lines that SWBT has in the rural areas, the direct responsibility is less than \$ 9M. In the rate of return regulatory environment, the imputation of SWBT's Yellow Page revenue exceeded that.

Q. Is it fair to restrict SWBT from receiving support from the KUSF?

A. Yes. SWBT requested internal rebalancing at the TSPC and the Legislature as well as in their comments when the Commission dealt with the universal service issues. This will give SWBT flexibility to manage its own affairs. In addition this will relieve any concern that SWBT is recovering revenues from the KUSF which are lost due to competitive forces.

Q. Kansas recently had eleven exchanges approved for sale by this Commission. How will the KUSF support work if an exchange is sold?

A. This is relevant because of the recent sales activity. In addition U.S. West, a former Bell Operating Company like SWBT, has been selling a number of exchanges. In regard to the rural exchanges which will not be receiving funds, I have concern about the impact to the KUSF if the rural exchanges are sold to a company which meets the criteria to qualify for support. I think we need to address this issue now as we set up the KUSF so that buyers and sellers will know how support will be treated. The one protection for the fund is to require the selling company to cover any support that can be claimed by the buyer by contributing that support to the KUSF. In exchanges not receiving support, it would be limited to the \$ 36.88 per line or its equivalent. For exchanges receiving support the amount should be the amount paid the selling LEC. Also all new LECs should be required to go to alternative regulation.

Q. How would you summarize Staff's plan for alternative regulation?

EXHIBIT 3

State of Kansas

ASSESSMENT FOR KUSF

Company Group	Reduction Amount	Required Funding	Rebalance Requested	KUSF Support
@ 14.1%				
SWBT#	73.6	53.3	73.6	.0
United#	16.3	4.6	6.8	9.5
ILECs*	18.7	2.1	2.1	16.6
KPSI	3.0	.0	.0	3.0
Total	111.6	60.0	82.5	
Funding Needed				29.1
Toll Providers		15.0		
Wireless & Others		14.1		
		<u>29.1</u>		<u>29.1</u>

- Increase requested to \$ 4.55 rebalance/line.

* - ILEC Rebalance Requested equals required funding amount